

Message Text

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ACTION EUR-12

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FM AMEMBASSY ANKARA
TO SECSTATE WASHDC 1818
INFO AMCONSUL ADANA
AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMCONSUL ISTANBUL
AMCONSUL IZMIR
AMEMBASSY PARIS

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USOECD

USEEC

E.O. 11652: NA
TAGS: EFIN, TU
SUBJ: ECEVIT GOVERNMENT'S TAX REFORM PROPOSALS

1. THE ECEVIT GOVERNMENT SUBMITTED A PACKAGE OF TAX REFORM PROPOSALS TO PARLIAMENT ON APRIL 17. THE PACKAGE INVOLVES AMENDMENT OF 210 ARTICLES OF 14 OF THE 21 DOMESTIC TAX ACTS. THE REFORMS BASICALLY ARE DESIGNED TO SHIFT THE INCOME TAX BURDEN FROM LOW AND MIDDLE INCOME GROUPS TO HIGH INCOME EARNERS, TO TIGHTEN TAX COLLECTION PROCEDURES ON FARMERS, SMALL BUSINESSMEN, ARTISANS AND OTHER SELF-EMPLOYED PERSONS, TO INCREASE EXCISE TAXES ON LUXURY CONSUMPTION, AND TO BROADEN THE SCOPE OF DOMESTIC

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PRODUCTION AND EXPENDITURE TAXES IN AN EFFORT TO LAY THE BASIS FOR EVENTUAL ESTABLISHMENT OF VALUE ADDED TAX.

2. THE PROPOSALS WILL ONLY marginally INCREASE GOVERNMENT TAX REVENUES SINCE THE THRUST OF THE MEASURES IS TOWARD IMPROVING TAX EQUITY AND INCREASING SOCIAL JUSTICE.

THIS IS DONE BY REDUCING THE TAX LIABILITY ON THOSE SUBJECT TO THE WITHHOLDING SYSTEM, PRIMARILY UNIONIZED WORKERS AND GOVERNMENT EMPLOYEES, ELIMINATING TAX LIABILITY FOR VERY LOW INCOME TAX PAYERS, AND INCREASING THE TAX LIABILITY ON BUSINESSMEN, FARMERS, AND CONSUMERS OF "LUXURY" ITEMS. THE GOVERNMENT CALCULATES THAT THE PACKAGE WILL YIELD A GROSS GAIN IN REVENUES OF TL 55 BILLION OF WHICH TL 40 BILLION WILL ACCRUE TO THE GENERAL BUDGET AND TL 15 BILLION TO LOCAL ADMINISTRATION BUDGETS; HOWEVER, AT THE SAME TIME, THESE MEASURES WILL YIELD TAX LOSSES OF TL 30 BILLION THROUGH A REDUCTION OF MARGINAL INCOME TAX RATES AND AN INCREASE IN THE MINIMUM STANDARD DEDUCTION. AN ADDITIONAL TL 5 BILLION WILL BE TRANSFERRED FROM THE GENERAL BUDGET TO LOCAL BUDGETS LEAVING A NET INCREASE IN REVENUE ACCRUING TO THE GENERAL BUDGET OF ONLY TL 5 BILLION.

3. EVEN THIS SMALL THEORETICAL REVENUE INCREASE IS QUESTIONABLE SINCE THE REVENUE LOSS FROM THE DOWNWARD SHIFT IN MARGINAL INCOME TAX RATES IS CERTAIN WHILE FULL ANTICIPATED REVENUE INCREASE FROM IMPROVED COLLECTION PROCEDURES IS NOT ASSURED. IN ADDITION THE PERSONAL INCOME TAX IS A RELATIVELY EFFICIENT TAX SINCE ACTUAL COLLECTIONS AVERAGE OVER 90 PERCENT OF ASSESSMENTS WHILE SOME OF THE TAXES SCHEDULED TO HAVE COLLECTION INCREASES HAVE, IN THE PAST, YIELDED DRASTICALLY LOWER LIMITED OFFICIAL USE

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COLLECTION/ASSESSMENT RATIOS, SOME AS LOW AS 30 PERCENT.

4. THE INDIVIDUAL TAXES WHICH MAKE UP THE TL 40 BILLION INCREASED YIELD ARE AS FOLLOWS:

TAX	ADDITIONAL YIELD (BILLIONS OF TURKISH LIRA)
INDIVIDUAL INCOME TAX	6.6
CORPORATE INCOME TAX	3.4
CAPITAL GAINS TAX	0.5
REAL ESTATE TAX	0.2
REAL ESTATE PURCHASE TAX	0.8
MOTOR VEHICLE TAX (ANNUAL)	2.5
MOTOR VEHICLE PURCHASE TAX	3.5
SALES TAX (RETAIL)	0.5
STAMP TAX (DOMESTIC)	8.0
PRODUCTION TAX (DOMESTIC)	6.5
FOREIGN TRAVEL TAX	0.5
INCREASED COLLECTION FROM IMPROVED PROCEDURES AND HIGHER PENALTIES ON TAX ARREARS	7.0

TOTAL 40.0

5. EVEN IF THE TAX PACKAGE WERE TO BE QUICKLY ENACTED BY PARLIAMENT WITH NO SIGNIFICANT CHANGE (NEITHER PROSPECT SEEMS LIKELY), THE IMPACT ON THE FISCAL YEAR 1978 BUDGET (MARCH 1, 1978 TO FEBRUARY 28, 1979) WOULD BE DIFFICULT TO ASSESS SINCE SOME MEASURES ARE RETROACTIVE TO JANUARY 1, SOME TAKE EFFECT ONE MONTH AFTER PASSAGE OF THE BILL, ONE IS EFFECTIVE SEPTEMBER 1, AND OTHERS TAKE EFFECT JANUARY 1, 1979. HOWEVER, THE OVERALL EFFECT OF THE PACKAGE, WHENEVER IT IS ENACTED, SHOULD SLIGHTLY WEAKEN THE GOVERNMENT'S CASH FLOW POSITION IN THE SHORT-TERM. THIS IS BECAUSE REVENUE LOSSES LIMITED OFFICIAL USE

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FROM LOWER INCOME TAX WITHHOLDING WOULD OCCUR IMMEDIATELY WHILE REVENUE GAINS FROM HIGHER INCOME TAXES ON THOSE FILING ANNUAL RETURNS WOULD OCCUR AT A MUCH LATER DATE. (TURKEY HAS NO SYSTEM OF QUARTERLY TAX ESTIMATION FOR SELF-EMPLOYED PEOPLE. THEIR TAX IS PAID IN THREE EQUAL MONTHLY INSTALLMENTS IN THE YEAR FOLLOWING THE YEAR OF TAX LIABILITY.) THESE LOSSES IN INCOME TAX REVENUE WILL BE PARTLY OFFSET BY INCREASED COLLECTIONS FROM THE PRODUCTION TAX, STAMP TAX AND SALES TAX, BUT THE NET EFFECT SHOULD BE TO REDUCE THE REVENUE FLOW IN THE SHORT TERM.

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6. THE ECEVIT GOVERNMENT HANDLED PUBLIC PRESENTATION OF THE TAX PACKAGE BADLY. BITS AND PIECES OF THE 210 REFORM MEASURES WERE LEAKED TO THE PRESS IN THE MONTH BEFORE THE BILL WAS FORMALLY SUBMITTED TO PARLIAMENT. PRESS STORIES YIELDED MUCH MISINFORMATION AND CREATED WIDESPREAD PUBLIC APPREHENSION ABOUT THE PACKAGE. THIS "BAD PRESS" COULD HAVE AN ADVERSE EFFECT ON CONSIDERATION OF THE PACKAGE IN PARLIAMENT.

7. THERE ARE THREE BASIC PERSONAL INCOME TAX REFORMS UNDER THE PROPOSED LEGISLATION.

A. THE FIRST ADJUSTS MARGINAL TAX RATES TO REDUCE THE LIMITED OFFICIAL USE

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TAX BITE ON THE MAJORITY OF TAXPAYERS WHO HAVE BEEN PUSHED INTO HIGHER TAX BRACKETS BY THE EFFECTS OF INFLATION ON THEIR INCOMES AND TO INCREASE THE TAX BITE ON THOSE WITH VERY HIGH INCOMES AS SEEN IN THE FOLLOWING TABLE (TAX RATES ARE ROUNDED-OFF FOR SIMPLICITY):

	OLD TAX RATE	NEW TAX RATE	DIFFERENCE
ANNUAL TAXABLE INCOME	PERCENT	PERCENT	DIFFERENCE
10,000	16	8	-8
30,000	24	14	-10
60,000	30	22	-8
100,000	36	30	-6
200,000	45	40	-5
500,000	54	50	-4
800,000	58	57	-1
1,000,000	60	59	-1
1,100,000	60	60	0
1,400,000	60	62	PLUS2
1,800,000	64	60	PLUS 4
2,000,000	65	60	PLUS5

THE MARGINAL TAX RATE ON ALL INCOMES UNDER TL 1.1 MIL-

LION IS REDUCED AND INCREASED ON INCOMES OVER THIS AMOUNT UP TO THE MAXIMUM RATE OF 65 PERCENT.

B. THE SECOND BASIC CHANGE INCREASES THE STANDARD DEDUCTION SO THAT THOSE WITH TAXABLE INCOMES OF TL 30,000 OR UNDER WILL HAVE NO TAX LIABILITY.

C. THE THIRD REFORM INVOLVES THOSE SMALL FARMERS AND SMALL BUSINESS MEN ELIGIBLE TO MAKE "LUMP-SUM" TAX PAYMENTS. THIS GROUP PAYS A FIXED TAX BASED ON LIMITED OFFICIAL USE

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THE TYPE OF CROP PRODUCED OR BUSINESS OPERATED. THE BILL INCREASES THE GROSS BUSINESS REVENUE LIMITS FOR THIS TYPE OF TAX PAYMENT AND THEREBY INCREASES THE NUMBER OF TAXPAYERS ELIGIBLE FOR THIS TYPE OF COVERAGE. IN 1975 (THE LATEST YEAR INFORMATION IS AVAILABLE) "LUMP-SUM" TAXPAYERS REPRESENTED 13 PERCENT OF TOTAL TAXPAYERS BUT PAID ABOUT ONE-HALF OF ONE PERCENT OF ALL TAXES.

7. THE NET EFFECT OF THESE, PLUS SEVERAL OTHER CHANGES DESIGNED TO ELIMINATE SOME TAX EXEMPTIONS, IS A LOSS OF ABOUT 23 BILLION IN INCOME-TAX REVENUE. IN THE 1978 BUDGET, THE INDIVIDUAL INCOME TAX WAS TO PROVIDE TL 93 BILLION, 41 PERCENT OF TOTAL TAX REVENUE OF TL 229 BILLION. IMPLEMENTATION OF THESE REFORMS WOULD REDUCE INCOME TAX COLLECTIONS BY 25 PERCENT.

8. IN A PRESS CONFERENCE ON APRIL 17, FINANCE MINISTER MUEZZINOGLU EXPLAINED THAT WORKERS AND CIVIL SERVANTS PAID ABOUT TWO-THIRDS OF TOTAL INCOME TAX WHILE BUSINESSMEN AND PROFESSIONALS PAID ABOUT ONE-THIRD. UNDER THE PROPOSED REFORMS THE INCOME TAX BURDEN OF THESE TWO GROUPS WOULD SHIFT TO A 50-50 RATIO.

9. COMMENT: THE TAX REFORM PROPOSALS RESPOND BASICALLY TO ECEVIT'S SOCIAL-DEMOCRATIC INTEREST IN IMPROVED TAX EQUITY AND SOCIAL JUSTICE. THE PROBLEM IS THAT TO ACHIEVE THESE SOCIO-POLITICAL GOALS, THE TAX REFORM PROPOSALS REDUCE POTENTIAL GOVERNMENT REVENUES FROM PROVEN EFFICIENT TAX SYSTEMS AND COUNT ON INCREASED REVENUES FROM CURRENTLY INEFFICIENT TAXES AND THE ALWAYS IFFY PROSPECT OF IMPROVED COLLECTION PROCEDURES. THE IMF STAFF ANALYSIS IN CONNECTION WITH THE STANDBY REQUEST (EBS/78/54) EXPECTED THESE MEASURES TO STRENGTHEN THE FISCAL SYSTEM. OUR ANALYSIS COMES TO THE OPPOSITE CONCLUSION THAT THE TAX PACKAGE WILL PROBABLY REDUCE THE GOVERNMENT'S REVENUE COLLECTION POTENTIAL ESPECIALLY IN THE SHORT-RUN.

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10. EMBASSY WILL REPORT OTHER ASPECTS OF THE TAX PACKAGE IN
SUBSEQUENT CABLES.

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